20

No. 91-615

IN THE SUPREME COURT
OF THE UNITED STATES
OCTOBER TERM, 1991

ALLIED-SIGNAL, INC.,
as successor-in-interest to
The Bendix Corporation,
Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,
Respondent.

On Writ of Certiorari to the
Supreme Court of New Jersey

AMICUS CURIAE BRIEF OF THE CITY OF NEW YORK IN SUPPORT OF RESPONDENT

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22

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Statutes

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Interest of the Amicus Curiae

Pursuant to Rule 37.5, the City of New York, as a political subdivision of the State of New York, is exercising the right to file a brief amicus curiae in support of the position of the Respondent, Director, Division of Taxation.

Pursuant to the Administrative Code of the City of New York §11-601 et seq., New York City imposes a General Corporation Tax on the "entire net income" of all corporations, domiciliary and non-domiciliary, which conduct business within the City. "Entire net income" includes both "business income" and "investment income". Although both types of income are taxed at the same rate, they are allocated to the City by different procedures in order to exclude from the tax base all income earned through non-City business activity.

A taxpayer with a regular place of business outside the City is entitled to allocate its business income through use of a "business allocation percentage" ("BAP"). The BAP is itself the average of three ratios: (i) the ratio of the taxpayer's New York City receipts to its total receipts, (ii) the ratio of the value of the taxpayer's New York City property to the total value of its property, and (iii) the ratio of the

taxpayer's New York City salaries and wages to its total salaries and wages. The taxpayer's total business income multiplied by its BAP results in the taxpayer's New York City business income, which is subject to tax. This formula is widely used in state taxation as an index of in-state business activity and has been accepted as a "benchmark" by this Court in Container Corporation of America v. Franchise Tax Board, 463 U.S. 159, 170 (1983).

Corporate taxpayers are also entitled to allocate investment income between New York City and non-City sources. For this purpose, the taxpayer's total investment income is multiplied by an "Investment Allocation Percentage" ("IAP"). The IAP is the average, of the issuer's allocation percentage of each of the entities in which the taxpayer has invested its capital, weighted according to the value of each investment.

The determination of a taxpayer's IAP may be illustrated as follows: Assume that a taxpayer has invested $1,100,000 in corporations "A", "B", and "C". Also assume that the taxpayer's investment in "A" is valued at $200,000, its investment in "B" at $300,000, and its investment in "C" at $600,000; and that "A's" New York City issuer's allocation percentage is 40%, "B's" is 15%, and "C's" is 10%. The sum of each of the taxpayers's investments multiplied by the respective issuer's allocation percentage is $185,000 [($200,000 x 40%) + ($300,000 x 15%) + ($600,000 x 10%)]. That amount ($185,000) is then divided by the sum of the taxpayer's total investments ($1,100,000), yielding the taxpayer's IAP (16.8%).

Determination of the issuer's allocation percentage depends upon the type of entity the issuer is considered for purposes of the City's corporate franchise tax. For general business

corporations, the issuer's allocation percentage is based on its the ratio of capital in the City, the components of which are business, investment, and subsidiary capital, to its total capital. In order to assist taxpayers, the City publishes each year a table of the issuer's allocation percentages for corporate securities. The product of the taxpayer's total investment income and the taxpayer's IAP is the amount of investment income included in the taxpayer's New York City tax base.

This investment allocation procedure, by considering solely the payor's allocation percentage, limits the City's tax to the taxpayer's share of the stream of income resulting from the payor's capital in New York City.

ARGUMENT

SINCE THE DUE PROCESS CLAUSE OF THE CONSTITUTION REQUIRES ONLY A "MINIMAL CONNECTION" BETWEEN A BUSINESS AND THE TAXING JURISIDICTION IN ORDER TO SUBJECT ITS ENTIRE INCOME TO APPORTIONMENT, THE DECISIONS IN ASARCO, INC. v. IDAHO STATE TAX COMMISSIONER, 458 U.S. 307 (1982), and F.W. WOOLWORTH CO. v. TAXATION & REVENUE DEPT., 458 U.S. 354 (1982), WHICH PERMIT TAXATION OF INVESTMENT INCOME ONLY IF ITS SOURCE IS A "FUNCTIONALLY INTERGRATED" BUSINESS, SHOULD BE OVERRULED.

(a)

A state or locality may impose taxes on corporations engaged in interstate commerce as long as there is no discrimination against out-of-state taxpayers and such taxes are properly related to income-producing activities within the taxing jurisdiction. Complete Auto Transit v. Brady, 430 U.S. 274, 279 (1977). This Court has repeatedly held that a non-discriminatory tax on corporate income is subject to constitutional prohibition only where

the taxpayer can show by "clear and cogent evidence" that the tax is imposed on income with no nexus to the taxing jurisidiction. Container Corporation of America v. Franchise Tax Board, 463 U.S. 159, 164 (1983); Exxon Corporation v. Wisconsin Department of Revenue, 447 U.S. 207, 221 (1980). Container Corporation offered the following statement of the governing legal principles (463 U.S. at 164):

> Under both the Due Process and the Commerce Clause of the Constitution, a state may not, when imposing an income-based tax, tax value earned outside its borders. In the case of a more-or-less integrated business enterprise operating in more than one State, however, arriving at precise territorial allocations of "value" is often an elusive goal, both in theory and in practice. For this reason and others, we have long held that the Constitution imposes no single formula on the States, and that the taxpayer has the distinct burden of showing clear and cogent evidence that the state tax results in extraterritorial values being taxed.

The principles governing taxation of corporate business income, frequently delineated

by this Court, flow logically from the fundamental prohibition against taxation of extra-territorial income. It is well settled that a state may tax receipts or income directly resulting from the taxpayer's in-state activities. Washington Department of Revenue v. Association of Washington Stevedoring Cos., 435 U. S. 734 (1978); Western Live Stock v. New Mexico Bureau of Revenue, 303 U.S. 250 (1938). In the case of a multi-state enterprise, a state may tax its properly apportioned share of the enterprise's total income. Northwest States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1958).

All income, regardless of its source, may also be taxed by apportioned methods which avoid taxation of extraterritorial income. This Court approved apportioned taxation of corporate investment income in a series of decisions concerning a Wisconsin dividend tax. International Harvester Co. v. Wisconsin

Department of Taxation, 322 U.S. 435 (1944); Wisconsin Department of Taxation v. J.C. Penney, Inc., 311 U.S. 435 (1940); Wisconsin v. Minnesota Mining and Manufacturing, 311 U.S. 452 (1940).

(b)

We submit that, since the sole requirements of the Due Process clause are a nexus between the taxing jurisdiction and either the taxpayer or the income, and fair apportionment of the taxable income, the unitary business principle imposed by ASARCO, Inc. v. Idaho State Tax Commissioner, 458 U.S. 307, reh'g denied, 459 U.S. 961 (1982), and F.W. Woolworth Co. v. Taxation and Revenue Dept., 458 U.S. 354, reh'g denied, 459 U.S. 961 (1982), serves no constitutional purpose and ought not be applied in determining the reach of a jurisdiction's taxing authority. A corporation should be considered in its totality, inclusive of income from all sources, whether

active or passive, whether generated inside or outside the taxing jurisdiction as long as it is fairly apportioned to its intrajurisdictional activities or values. The unitary business principle, as applied in ASARCO and Woolworth, encourages an unrealistic fragmentation of the corporate entity, unwieldy in application, constitutionally unwarranted, and totally unnecessary in order to achieve equity in taxation.

This Court has consistently considered all aspects of a complex business enterprise as a single organic entity. In Butler Brothers v. McColgan, 315 U.S. 501, 508 (1942), the Court, quoting from Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123, 133 (1931), stated: "The enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits." In Mobil Oil Corp.

v. Commissioner of Taxes, 445 U.S. 425, 438 (1980), the Court stated that "factors of profitability arise from the operation of the business as a whole...". ASARSO and Woolworth are aberrations from this otherwise consistent treatment of a business enterprise.

The dissenting opinion of Justice O'Connor in ASARCO, Inc. v. Idaho State Commissioner, 458 U.S. 307, 331 (1982), while discussing due process requirements within the context of the unitary business principle, points toward the abandonment of the principle itself rather than merely criticizing the majority's application of it to the facts in ASARCO and Woolworth. In support of her assessment that the majority had negatively impacted upon the delicate balances involved in fiscal policy-making and had "'imprison[ed] the taxing power of the states within formulas that are not compelled by the Constitution'" [citing Wisconsin v. J.C. Penney Co., 311 U.S. 435, 445 (1940)], Justice

O'Connor recognized that "a multijurisdictional business is 'an organic system', Wallace v. Hines, 253 U.S. 66, 69 (1920) (Holmes, J.), whose income cannot sensibly be reduced to the sum of the hypothetical incomes of distinct component parts, each wrenched from the unitary whole and conceptually confined to operations within a single State." 458 U.S. at 332-333.

In arguing that ASARCO had failed to meet its burden of demonstrating that the tax levy upon its investments was unconstitutional, Justice O'Connor stated (458 U.S. at 337-338):

> [A]ssuming, arguendo, that the contested investments were in fact passive, ASARCO has failed to show that its holdings were divorced from its management of the financial requirements of its nonferrous metals business. For all we know, ASARCO's investments were triggered by its need to obtain a return on idle financial resources accumulated for the future operation of its own primary business.
>
> ASARCO does not, and could not, contend that all its investment income is per se beyond the taxing power of the nondomiciliary States in which it

operates. Rather, it concedes that the Due Process Clause permits Idaho to tax, on an apportioned basis, the income ASARCO earned on short-term investments of its working capital. After all, an appropriate amount of liquid working capital is necessary to the day-to-day operation of a business, and any return earned from its temporary investment is a byproduct of the operation of the business. ASARCO thus admits that Idaho could tax a portion of the income realized from an investment in, say, short-term commercial paper, even though the underlying operations of the issuing companies were far less related to ASARCO's nonferrous metals business than the operations of the five subsidiaries at issue here.

The interim investment of retained earnings prior to their commitment to a major corporate project, however, merely recapitulates on a grander scale the short-term investment of working capital prior to its commitment to the daily financial needs of the company. Just as companies prefer to maintain a cushion of working capital rather than resort to the short-term capital markets on an hourly basis for the money necessary to operate their businesses, many enterprises prefer to acquire the capital necessary for the expansion and replacement of plants and equipment by creating long-term funds, rather than resort to the vagaries of the capital markets. In order to prevent the accumulating capital from sitting idle, such funds are usually invested in financial assets

> with a degree of liquidity appropriate to the money's intended ultimate use. Any return ASARCO earned on such investments plainly would be functionally related to the conduct of its non-ferrous metals business and, therefore, taxable by Idaho on an apportioned basis as unitary business income.

By imposing limitations on state and local taxing authorities not required by the Due Process clause, the Court may have been trying to prevent potential systemic inequities. The remedy, however, should not be sought in the guise of constitutional restraints which, in reality, unconstitutionally interfere with the legitimate reach of the states' power to tax. Where significant inequities arise, remedies less drastic than the erection of constitutional barriers are available. Once a nexus with a corporation is established, the Due Process clause permits the state to levy a tax on all the income of the business as long as it is properly apportioned.

(c)

The Due Process and Commerce clauses require that nexus exist between the entity or income sought to be taxed and the taxing jurisdiction. In upholding the City's method of taxing corporations, the New York Court of Appeals recently stated: "Nowhere did the [Supreme] Court indicate that it intended that the existence of a unitary business relationship would be the exclusive means for satisfying the nexus requirement when a State or municipality sought to tax the investment income that a nondomiciliary corporation earned." (emphasis in original). Allied Signal, Inc. v. Commissioner of Finance, 79 NY2d 73, 81 (1991). As explained supra, pp. 2-5, the City's General Corporation Tax imposes a tax on investment income based on the taxpayer's investment allocation percentage, which itself is based on the relationship the issuers of the securities, in which the taxpayer has invested, have to the

City. Under the City's conservative tax system, there must not only be nexus between the City and the taxpayer, but also nexus between the City and the investment income. Whether a unitary business exists between the income and the nondomiciliary taxpayer need not be considered under the City's methodology.

As indicated above, we respectfully urge this Court to overrule ASARCO and Woolworth because the Due Process clause imposes no constitutional requirement that a unitary relationship exist before a state or municipality can reach the investment income of a nondomiciliary. The constitutional principal that governs state taxation of multijurisdictional corporations is solely nexus between the entity to be taxed and the jurisdiction seeking to tax it. Once the fundamental requirement of nexus is met, the method devised by the state or municipality to tax the income of the nondomiciliary corporation must exhibit a

rational relationship to the intrajurisdictional values of the corporation. But, within that framework, jurisdictions should be afforded the widest latitude in fashioning a method of apportionment which reaches only those intrajurisdictional values.

(d)

Because of the unique circumstances of ASARCO and Woolworth, their overruling was clearly foreshadowed, even at the time they were rendered, and was effectively accomplished by Container Corporation v. Franchise Tax Board, 463 U.S. 159 (1983). We endorse the position set forth by Amici Virginia, et al., to be filed concurrently with our brief, that Chevron Oil v. Huson, 404 U.S. 97 (1971), provides the appropriate standard for resolving retroactivity. The Chevron standards for retroactive application of the overruling of ASARCO and Woolworth are met.

CONCLUSION

THE DECISIONS OF THIS COURT IN ASARCO AND WOOLWORTH SHOULD BE OVERRULED, AND THE JUDGMENT BELOW SHOULD BE AFFIRMED AND GIVEN RETROACTIVE EFFECT.

Respectfully submitted,

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